

RD AN No. 3777 (1944-E)
August 1, 2002

TO: State Directors
Rural Development

ATTENTION: MFH Program Directors and Coordinators

FROM: Arthur A. Garcia *(Signed by Arthur A. Garcia)*
Administrator
Rural Housing Service

SUBJECT: Return on Investment (ROI)
Section 515 New Construction

PURPOSE/INTENDED OUTCOME:

The purpose of this Administrative Notice (AN) is to provide guidance on determining the return on investment (ROI) for Section 515 new construction borrower contributions, including additional contributions above the required amount for the Section 515 loan. Guidance is also provided on completing Form RD 1944-34, "Loan Agreement", and Form RD 1944-51, "Multifamily Housing Obligation - Fund Analysis".

COMPARISON WITH PREVIOUS AN:

There is no previous AN on this subject.

IMPLEMENTATION RESPONSIBILITIES:

States are responsible for establishing the return on investment (ROI) for Section 515 new construction loans in accordance with the applicable provisions of RD Instruction 1944-E and an analysis of project feasibility.

EXPIRATION DATE:
July 31, 2003

FILING INSTRUCTIONS:
Preceding RD Instruction 1944-E

REGULATORY PROVISIONS PERTAINING TO THE BORROWER'S INITIAL INVESTMENT AND RATE OF RETURN:

- §1944.215(n), "Establishing profit base on initial investment," contains the following provisions:
 - Limited profit borrowers will be permitted a return not to exceed 8 percent per year on their initial investment determined at time of loan approval.
 - The amount of the initial investment will be reflected in the loan agreement or loan resolution.
 - The amount of the initial investment may exceed the required contribution and may earn a return, provided the contributions are from the applicant's own resources and do not exceed the security value of the property when added to the loans and grants from all sources.
 - Low-income housing tax credit (LIHTC) syndication proceeds contributed to the project may be considered the applicant's own resources for the portion that exceeds the developer's fee and the amount expected to be contributed to the transaction, as determined by the State Agency that administers the LIHTC. (§1944.215(n)(1))
- §1944.233, "Participation with other funding sources," contains the following provisions:
 - RHS rental assistance (RA) may be provided on any unit where the basic rent does not exceed what the basic rent would have been if RHS provided full financing. (§1944.233(a)(3))
 - The minimum required borrower contribution is based on the RHS loan amount. (§1944.233(d)(1))
 - A loan from the borrower to the project may be considered if the funds are from the borrower's own resources. LIHTC proceeds may be considered the borrower's own resources as provided in §1944.215(n)(1). (§1944.233(d)(3))

REQUIRED (MINIMUM) CONTRIBUTION VERSUS ADDITIONAL CONTRIBUTION:

The borrower's *required* contribution is based on the RHS loan, not the total development cost or appraised value. For a limited profit borrower utilizing LIHTC, the required contribution is 5 percent of the RHS loan; for non-LIHTC properties, the required contribution is 3 percent of the RHS loan. The borrower's *additional* contribution is the amount above the required contribution that is from the borrower's own resources and, when added to the loans and grants from all sources, is within the RHS appraised value of the property or the RHS total development cost (TDC), whichever is less. Often the borrower must contribute funds to cover development costs that exceed the RHS appraised value. These funds are not eligible to earn a return.

ROI ON THE REQUIRED CONTRIBUTION:

ROI of up to 8 percent may be paid on the required contribution (3 or 5 percent of the RHS loan), subject to the provisions of RD Instruction 1930-C, Exhibit B, Paragraph XII. B.

ROI ON ADDITIONAL CONTRIBUTIONS ABOVE THE REQUIRED 3 OR 5 PERCENT OF THE SECTION 515 LOAN:

Additional borrower funds that meet the conditions of §1944.215(n) are potentially eligible for ROI. However, the effect of paying ROI on the additional contribution must be analyzed in terms of all other applicable provisions of the Instruction, as well as overall project feasibility:

- If RHS rental assistance (RA) is being provided, basic rents may not exceed the basic rents if RHS had provided full financing (§1944.233(a)(3)). Therefore, the effect of paying ROI on additional contributions must be examined, along with the other factors that affect the budget and basic rents.
- If RA is being provided and there are factors that result in lower than 1-percent basic rents, ROI may be considered on additional borrower contributions, up to an amount that would contain rents at the 1 percent level. For example, if a portion of the other funding is provided by grants or forgiven loans, the overall debt service may be lower than the RHS 1 percent debt service, resulting in lower than 1 percent rents.
- If it appears the budget would permit ROI on additional borrower contributions, the budget must be carefully reviewed to ensure that it is realistic and that operating costs are reasonable for same-type properties in the area.
- ROI on additional contributions is subject to the provisions of RD Instruction 1930-C, Exhibit B, Paragraph XII. B.

PROJECT FEASIBILITY:

RHS basic rents may not exceed the rents for comparable units in the market. For non-RA properties, the project is not feasible unless the rents are competitive with like-type rentals. For RA properties, competitive rents will help to contain RA costs and ensure project feasibility in the event RA is not available in the future.

In communities with a need and demand for affordable rental housing and no comparable rental units, RHS basic rents may exceed market rents for the non-comparable rental units provided the rents are reasonable for like-type properties in the area and RA is being provided to make the rents affordable to very-low income households. In such instances, the circumstances and justification for exceeding market rents must be thoroughly documented.

RESERVE REQUIREMENTS:

RD Instruction 1944-E, §1944.233(e) states that RHS reserve requirements will be determined on a case-by-case basis, taking into account the requirements of the other lenders, so that the aggregate fully funded reserve equals at least 10 percent of the RHS TDC or appraised value, whichever is greater. In highly leveraged proposals utilizing multiple funding sources, the soft costs associated with the various funding sources may increase the TDC substantially above the cost of replacing the property. Basing the reserve requirement on the TDC may result in an unnecessarily high reserve deposit; however, caution must be exercised to ensure that the reserve requirement is sufficient to meet future capital needs. A request to establish the reserve requirement in an amount that is less than 10 percent of the RHS TDC or appraised value, whichever is greater, must be supported by a capital needs assessment and must receive prior concurrence from the National Office.

COMPLETING FORM RD 1944-34, "LOAN AGREEMENT":

The Loan Agreement and Forms Manual Insert (FMI) will be revised in the future to include the procedural references for participation loans. In the interim, the guidance in RD Instruction 1944-E for determining the amount of borrower contribution and return on investment takes precedence over the FMI instructions, which were written for proposals in which RHS was the sole lender.

For proposals that include additional borrower contributions above the required 3 or 5 percent of the RHS loan, the following guidance should be followed in completing the Loan Agreement:

- Line 4, "Borrower Contribution," is the amount that the borrower is required to place on deposit to be dispersed prior to disbursement of interim loan funds or any RHS loan funds. This must be an amount at least equal to the required contribution of 3 or 5 percent of the RHS loan. Insert additional language indicating the total amount the borrower is contributing and the amount that will be placed on deposit and dispersed prior to disbursement of other funds, or include the additional language in an Addendum to the Loan Agreement.
- On line 5 b 1, "To pay dividends to the partners of up to 8 percent per annum of the borrower's initial investment of _____," enter the 3 or 5 percent required contribution on the RHS loan. Include additional language indicating the additional ROI that may be paid in accordance with the applicable regulatory provisions, and the total combined annual ROI.
- Obtain OGC's guidance in making changes to the Loan Agreement.
- Have the borrower initial all changes or sign the Addendum.

Attachment 1 is a sample modified Loan Agreement.

COMPLETING FORM RD 1944-51, "MULTI-FAMILY HOUSING OBLIGATION - FUND ANALYSIS":

In block 34, "User Contributed Funds," enter the total amount the borrower is contributing that, when added to the loans and grants from all sources, equals the RHS TDC. The RHS TDC should be entered in block 35, "Total Cost of Project." Include a notation to block 34 that shows the amount of borrower contribution with return (the amount eligible for ROI) and the amount of contribution without return, as entered on the Loan Agreement. The borrower contributed funds with return and the funds without return are also entered on the last page of the M5V preliminary cost transaction in AMAS.

ROI SPREADSHEET:

Attachment 2 is a spreadsheet that may be used as a tool in determining ROI. It should be used in conjunction with a full review of the budget and project feasibility.

Questions regarding this AN may be directed to the Multi-Family Housing Processing Division at (202) 720-1604.

Attachments

LOAN AGREEMENT

- ☐ **RRH Loan to a Partnership Operating on a Profit Basis**
☐ **RRH Loan to a Limited Partnership Operating on a Profit Basis**
☐ **RRH Loan to a Partnership Operating on a Limited Profit Basis**
☐ **RRH Loan to a Limited Partnership Operating on a Limited Profit Basis**

1. Parties and Terms Defined. This agreement dated May 15, 2002 of the ABC Limited Partnership, a Partnership, duly organized and operating under the State of XX, herein called "Partnership", whose post office address is 100 Main Street, Anytown, XX, with the United States of America acting through the Rural Housing Service or a successor agency, United States Department of Agriculture, herein called "the Government", is made in consideration of a loan, herein called "the loan", to Partnership in the amount of \$ 280,000.00 made or insured, or to be made or insured, by the Government pursuant to section 515(b) of the Housing Act of 1949 to build a 24-unit family project. The loan may be sold and insured by the Government. The loan shall be used solely for the specific eligible purposes for which it is approved by the Government in order to provide rental housing and related facilities for eligible occupants, as defined by the Government in rural areas. Such housing, facilities, and the land constituting the site are herein called "the housing". The indebtedness and other obligations of the Partnership under the note evidencing the loan, the related security instrument and any related agreement are herein called the "loan obligations".

2. Execution of Loan Instruments. To evidence the loan the Partnership shall issue a promissory note (herein referred to as "the note"), signed by the Partnership, on behalf of the Partnership for the amount of the loan, payable in installments over a period of 30 years, bearing interest at a rate, and containing other terms and conditions, prescribed by the Government. To secure the note or any indemnity or other agreement required by the Government. The Partnership is to execute a real estate security instrument giving a lien upon the housing and upon such other real property of the Partnership as the Government shall require, including an assignment of the rents, subsidies, revenues and profits as collateral security to be enforced in the event of any default by the Partnership, and containing other terms and conditions prescribed by the Government. The Partnership is to execute any other security instruments and other instruments and documents required by the Government in connection with the making or insuring of the loan. The indebtedness and other obligations of the Partnership under the note, the related security instrument, and any related agreement are herein called the "loan obligation."

3. Equal Opportunity and Nondiscrimination Provisions. The General Partners are hereby authorized and directed to execute on behalf of the Partnership (a) any undertakings and agreements required by the Government pursuant to Title VIII of the Civil Rights Act of 1968 as amended by the Fair Housing Amendments Act of 1988 related to Fair Housing regarding nondiscrimination in the use and occupancy of housing, (b) Form RD 400-1 entitled "Equal Opportunity Agreement", including an "Equal Opportunity Clause" to be incorporated in or attached as a rider to each construction contract the amount of which exceeds \$10,000 and any part of which is paid for with funds from the loan, and (c) Form RD 400-4, entitled "Assurance Agreement (under Title VI, Civil Rights Act of 1964)", a copy of which is attached hereto and made a part hereof, and any other undertakings and agreements required by the Government pursuant to lawful authority.

4. Borrower Contribution. The amount of \$ 14,737.00 * to be contributed by the Partnership from its own funds for the land purchase or development will be placed or deposited with the lender and dispersed prior to any disbursement of interim loan funds or any loan funds from the Government.

* Borrower is contributing a total of \$320,000, of which \$14,737 is the required contribution on the RHS loan and must be placed on deposit and dispersed prior to disbursement of other funds.

According to the Paperwork Reduction Act of 1995, no persons are required to respond to a collection of information unless it displays a valid OMB control number. The valid OMB control number for this information collection is 0575-0047. The time required to complete this information collection is estimated to average 15 minutes per response, including the time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information.

5. Accounts for Housing Operations and Loan Servicing. The Partnership shall establish on its books the following accounts, which shall be maintained so long as the loan obligations remain unsatisfied: a General Operating Account, a Tenant Security Deposit Account and a Reserve Account.

a. General Operating Account. By the time the Government loan is closed or interim funds are obtained, whichever occurs first, the Partnership shall provide cash from the Borrower's own funds in an amount totaling \$ 20,000.00. Use of deposited cash will be in accordance with 7 CFR part 1930, subpart C or any successor regulation.

b. Reserve Account. Transfers at a rate not less than \$ 10,000.00 annually shall be made to the Reserve Account until the amount in the Reserve Account reaches the minimum sum of \$ 100,000.00 or such higher amount later agreed to by the Government and shall be resumed at any time when necessary, because of disbursements authorized by the Government from the Reserve Account to restore it to said sum. Withdrawal and use of funds deposited to this account will be in accordance with 7 CFR part 1930, subpart C or any successor regulation. With prior consent of the Government, funds in the Reserve Account may be used by the Partnership:

1) To pay dividends to the partners of up to 8 percent per annum of the borrower's initial investment of \$ 14,737.00 ** provided the Partnership determines that after such disbursement (a) the amount in the Reserve Account will be not less than that required by this section to be accumulated by that time (less any disbursements authorized by the Government), and (b) the amount in the Reserve Account will likely not fall below that required to be accumulated during the next 12 months.

2) To pay dividends to partners or for any other purpose desired by the Partnership, provided the Partnership determines that after such disbursement (a) the amount in the Reserve Account will not be less than that required by this section to be accumulated by that time (less any disbursements authorized by the Government), and (b) the amount in the Reserve Account will likely not fall below that required to be accumulated during the next 12 months.

6. Regulatory Covenants. So long as the loan obligations remain unsatisfied, the Partnership shall comply with all appropriate regulations of the Government and shall:

a. Impose and collect such fees, assessments, rents, and charges that the income of the housing will be sufficient at all times for operation and maintenance of the housing, payments on the loan obligations, and maintenance of the accounts herein provided for.

b. Establish and maintain complete books and records relating to the housing's financial affairs, cause such books and records to be audited at the end of each fiscal year, promptly furnish the Government without request a copy of each audit report, and permit the Government or its representative to inspect such books and records at all reasonable times.

c. If required or permitted by the Government, revise the accounts herein provided for, or establish new accounts, to cover handling and disposition of income from and payment of expenses attributable to the housing or to any other property securing the loan obligations, and submit regular and special reports concerning the housing or financial affairs.

d. Agree that if any provisions of its organizational documents or any verbal understandings conflict with the terms of this loan agreement, the terms of the loan agreement shall prevail and govern.

e. Unless the Government gives prior consent:

1) Not use the housing for any purpose other than as rental housing and related facilities for eligible occupants.

2) Not enter into any contract or agreement for improvements or extensions to the housing or other property securing the loan obligations.

3) Not change the membership by either the admission or withdrawal of any general partner(s) nor permit general partner(s) to maintain less than an aggregate of 5 percent, financial interest in the organization nor cause or permit voluntary dissolution of the Partnership nor cause or permit any transfer or encumbrance of title to the housing or any part thereof or interest therein, by sale, mortgage, lease, or otherwise.

4) Not borrow any money, nor incur any liability which would have a detrimental effect on the housing.

** Additional ROI of up to 8 percent per annum may be paid on additional borrower contribution of \$114,028, subject to compliance with RD Instruction 1944-E, 1944.233(a)(3) and RD Instruction 1930-C, Exhibit B, XII B. Total ROI per annum may not exceed \$10,301 (8 percent on required contribution of \$14,737 and additional contribution of \$114,028).

f. Submit for the housing the required reports as per 7 CFR part 1930, subpart C or any successor regulation to the Government for prior review.

g. If required by the Government, modify and adjust any matters covered by clause (f) of this section.

h. Comply with all its agreements and obligations in or under the note, security instrument, and any related agreement executed by the Partnership in connection with the loan.

i. Not alter, amend, or repeal without the Government's consent this agreement or the Partnership Agreement, which shall constitute parts of the total contract between the Partnership and the Government relating to the loan obligations.

j. Take other action as may be required by the Government in connection with the operation of the housing, or with any of the Partnership's operations or affairs which may affect the housing, the loan obligations, or the security.

k. If the return on investment for any year exceeds 8 percent annum of Partnership's initial investment of \$ ~~14,737 (required)~~ and \$114,028 (additional investment), the Government may require that the borrower reduce rents the following year and/or refund the excess return on the investment to the tenants or use said excess in a manner that will best benefit the tenants.

7. General Provisions.

a. It is understood and agreed by the Partnership that any loan made or insured will be administered subject to the limitations of the authorizing act of Congress and related regulations, and that any rights granted to the Government in this agreement or elsewhere may be exercised by the Government in the Government's sole discretion.

b. The provisions of this agreement are representations to the Government, to induce the Government, to make or insure a loan to the Partnership as aforesaid. If the Partnership should fail to comply with or perform any provision of this agreement or any requirement made by the Government pursuant to this agreement, such failure shall constitute default as fully as default in payment of amounts due on the loan obligations. In the event of such failure, the Government at its option may require specific performance, declare the entire amount of the loan obligations immediately due and payable and, if such entire amount is not paid forthwith, may take possession of and operate the housing and proceed to foreclose its security and enforce all other available remedies, or take such other action as it deems necessary to enforce the provisions of this agreement.

c. Any provisions of this agreement may be waived by the Government in its sole discretion, or changed by agreement between the Government and the Partnership to any extent such provisions could have been foregone or agreed to in amended form, initially.

d. Any notice, consent, approval, waiver or agreement must be in writing.

e. This loan agreement shall be subject to the present regulations of the Government and to its future regulations and provisions hereof.

f. The Partnership agrees that no person with a disability will be subjected to discrimination in employment or denied the benefits of the housing because of such disability. It will comply with the requirements of the Fair Housing Act, 42 U.S.C. 360 et seq., the Fair Housing Amendments Act of 1988, the Rehabilitation Act of 1973, 29 U.S.C. 794, the Americans with Disabilities Act of 1990, 42 U.S.C. 12101 et seq., and the implementing regulations of the Department of Agriculture, 7 CFR part 15b.

g. This agreement may be cited in the security instrument and any other instruments as the "Loan Agreement" of May 15 2002 , .

ABC Limited Partnership
PARTNERSHIP NAME

By:

<hr/>	<i>(Signed by John Q. Public)</i>
<hr/>	John Q. Public, General Partner
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Attachments:
RD Instruction 1944-E, 1944.233(a)(3)
RD Instruction 1930-C, Exhibit B, XII B
Documentation of ROI calculation

Return on Investment (ROI)
Calculation for Section 515
New Construction with RA
and Leveraged Funds

Attachment 2

BORROWER:	RHS FULL FINANCING	PROPOSED FINANCING	FUNDS ELIGIBLE FOR ROI	RETURN TO OWNER	ANNUAL RESERVE REQUIREMENT
STEP 1: CALCULATE DEBT SERVICE AND ROI AT FULL RHS FINANCING					
1. Enter RHS Appraised Value					
2. Enter RHS TOTAL DEVELOPMENT COST (TDC)					
3. Smaller of 1 or 2	\$ -				
4. Enter percentage: .95 or .97 (maximum RHS loan)					
5. Maximum RHS loan	\$ -				
6. Annual debt service if Agency made full loan: 50 YRS @ 1% PAYMENT/YR	\$ -				
7. Amount eligible for ROI (3 or 5 percent of maximum RHS loan on line 5)	\$ -				
8. Annual 8% ROI on amount on line 7	\$ -				
9. Total "bottom line" debt service and ROI if RHS provided full financing (line 6 + line 8)	\$ -				
STEP 2: COMPARE TO ANNUAL DEBT SERVICE AND ROI WITH PROPOSED FINANCING					
10. Enter actual RHS loan amount					
11. 50 YRS @ 1% PAYMENT/YR (RHS Loan)		\$ -			
12a. Enter loan 2 amount (if interest is being charged; otherwise enter total deferred loans on line 16)					
12b. Enter loan 2 amortization period (years)					
12c. Enter loan 2 interest rate. (example: ".0475" for 4.75%)					
13. Loan 2 payment		\$ -			
14a. Enter loan 3 amount					
14b. Enter loan 3 amortization period (years)					
14c. Enter loan 3 interest rate (example: ".0475" for 4.75%)					
15. Loan 3 payment		\$ -			
16. Enter TOTAL of grants AND deferred loans					
17. Total grant and deferred loan "payment" based on 1 percent 50 year financing (see NOTE)		\$ -			
18. Total loans and grants as proposed (line 10 + 12a + 14a + 16)		\$ -			
19. Total annual financing cost as proposed (line 11 + 13 + 15 + 17)		\$ -			
20. Amount eligible for "base" ROI (3 or 5 % of actual RHS loan)		\$ -	\$ -		
21. Annual 8% ROI on amount on line 20		\$ -		\$ -	
22. Total proposed financing cost plus ROI on actual RHS loan (line 19 + line 21)		\$ -			
STEP 3: DETERMINE THE AMOUNT OF FUNDS NEEDED FROM BORROWER:					
23. Gap between RHS TDC and total loans and grants (line 2 minus line 18)		\$ -			
STEP 4: COMPARE THE COST OF THE FULL RHS FINANCING PLUS ROI (line 9) TO THE COST OF THE PROPOSED FINANCING PLUS BASE ROI (line 22)					
24. Difference between full RHS and proposed (line 9 minus line 22):		\$ -			
25. Cost savings		\$ -			
26. Calculate the amount that will generate the ROI shown on line 25 (line 25 divided by .08)		\$ -			
27. Compare to amount of funds available within appraised value. (Appraised value (line 1) minus total loans and grants (line 18) minus base funds eligible for ROI (line 20)).		\$ -			
28. Smaller of line 26 or 27		\$ -	\$ -		
29. Annual 8% ROI on amount on line 28				\$ -	
STEP 5: DETERMINE TOTAL 8% RETURN ON INVESTMENT					
30. Total funds eligible for 8% ROI (line 20 plus line 28). [Enter on Loan Agreement]			\$ -		
31. Total 8% ROI (line 21 + 29) (this figure also equals line 30 * .08). [Enter on Loan Agreement]				\$ -	
NOTE: Grants and deferred loans are treated as a 1% RHS loan for purposes of the total debt service calculation, in order to neither benefit nor penalize the owner in the ROI calculations.					

STEP 6: DETERMINE ANNUAL RHS RESERVE REQUIREMENT			
32. <i>Larger</i> of RHS TDC or appraised value (from line 1 or line 2)	\$	-	
33. Annual reserve requirement (1% of amount on line 32)		\$	-